

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Ridley-Thomas Analyst: John Pavalasky Bill Number: AB 2484
Related Bills: See Legislative History Telephone: 845-4335 Amended Date: April 26, 2004
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Depreciation Deduction/No Deduction Allowed For Large Sport Utility Vehicle/Fuel Efficient Vehicle Credit

SUMMARY

This bill would deny the general California business incentives relating to vehicles when a business purchases a large sport utility vehicle (SUV). The revenue from disallowing these incentives would be used to fund a credit for the purchase and use of fuel efficient vehicles in this state.

SUMMARY OF AMENDMENTS

The April 26, 2004, amendments struck out the previous contents and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, this bill is intended to provide taxpayers with an incentive to purchase fuel efficient vehicles.

EFFECTIVE/OPERATIVE DATE

This bill, as a tax levy, would be effective immediately. However, as amended April 26, 2004, this bill provides that the credit would apply to taxable years beginning on or after January 1, 2005, and before January 1, 2009, and a sunset date of January 1, 2010, is provided. The bill provides that the business incentive disallowance would apply to property placed in service on or after January 1, 2005, and before January 1, 2009, and a sunset date of January 1, 2010, is provided.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the technical concern relating to the repeal date of the credit discussed in this analysis.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

5/11/04

FISCAL IMPACT

This bill would not significantly impact the department's programs or operations.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the following table reflects the estimated impact of this bill:

Revenue Impact of AB 2484 as Amended April 26, 2004 For Taxable Years Beginning On Or After 1/1/2005 Fiscal Years Assumed Enactment After 6/30/2004 (In Millions)				
	2004-05	2005-06	2006-07	2007-08
Sport Utility Vehicle Deductions	\$5	\$20	\$30	\$20
Qualified Vehicle Applied Credits	\$0	-\$20	-\$30	-\$25
Revenue Impact	\$5	\$0	\$0	-\$5

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The impact of this bill would depend upon the following:

- The number and costs of large sports utility vehicles
- The amount of reduced depreciation and expense deductions that would have been allowable under current law
- The amount of tax decreases resulting from the resale of large sports utility vehicles at higher cost basis
- The number of qualified reduced-emission vehicles sold for use in California
- The average tax credit certificate issued per qualified reduced-emission vehicle
- The number of individuals claiming the reduced-emission vehicle credit
- The average applied credit against tax liabilities.

For purposes of this analysis, information obtained from a report released by US Public Interest Research Group in 1999 was used. In addition, the following assumptions were made:

- (1) Assumed that approximately 50% of large SUVs sold or leased currently are allowed some sort of deduction. Of these vehicles it is estimated that approximately 20% qualify for both operating lease deductions and depreciation deductions, and 10% would be exempt from this bill.
- (2) The average annual deduction per vehicle is \$5,000.
- (3) The average write-off period for these vehicles is three years.
- (4) The business use of leased SUVs would decline by 15% annually as a result of this bill.
- (5) The average marginal tax rate of 6% was used.

SUV Deductions

To arrive at the annual revenue gain, it was determined from the US Public Interest Research Group's report that approximately 730,000 qualifying vehicles would be sold or leased in the United States in 2005. Of this total it is estimated that 11% would be located in California (84,000).

Assuming 55% of the vehicles would no longer receive an average deduction of \$5,000, disallowed deductions would amount to approximately \$230 million for vehicles purchased or leased in 2005. Assuming an average marginal tax rate of 6% the first year, revenue gain is estimated to be approximately \$14 million ($6\% \times \$230 \text{ million} = \14 million). The fiscal-year estimates above reflect changes in estimated tax and final tax payments. That is, it was assumed that 35% of the \$14 million first-year revenue gain would be reflected in increased estimate payments in the 2004-05 fiscal year resulting in the \$5 million estimate for that fiscal year. Credits, however, exhibit a different fiscal-year pattern as discussed below.

The above revenue impact for the SUV deduction represents a timing effect, reduced depreciation deductions, and expenses offset in future years by a decrease in the amount of gain realized from the sale of the vehicle due to its unreduced basis under this bill.

Qualified Vehicle Applied Credits

Based on information from an article published in the San Francisco Chronicle in October of 2002, and information provided by advocates for fuel efficiency, it is estimated that the number of qualifying vehicles will exceed the estimated increase in state taxes when divided by the maximum credit allowable per vehicle of \$1,000. Therefore, all of the estimated increase in state taxes for any given fiscal year would be allocated to the credit.

The fiscal year cash flow patterns reflect applied credits in the respective years and are based on an analysis of how taxpayers adjust their tax payments to reflect a change in liability resulting from current law. That is, prior fiscal year estimated tax payments are not typically adjusted to take into account the availability of the credit but instead, because of the carryover, the application of the credit is reflected in the succeeding fiscal year. Thus, applied credits reflect not only the credits allocated in 2007-08, but also the carryover of unapplied credits from prior fiscal years.

LEGISLATIVE HISTORY

AB 1390 (Ridley-Thomas, 2003/2004) would have allowed a tax credit for the purchase of a new fuel-efficient vehicle if the Department of Finance (DOF) certified that it finds projected state revenues exceed projected state expenditures. This bill did not pass out of the house of origin.

AB 198 (Nation, 2003/2004) would deny the general California business incentives relating to vehicles when a business purchases a large sport utility vehicle (SUV). The revenue from disallowing these incentives would be used to fund a credit for the purchase and use of qualified reduced-emission vehicles in this state. This bill is in the Senate Revenue and Taxation Committee.

AB 848 (Nation, 2003/2004) would deny the general California business incentives relating to vehicles when a business purchases a large sport utility vehicle (SUV). The revenue from disallowing these incentives would be used to fund a credit for the purchase and use of qualified reduced-emission vehicles in this state. This bill did not pass out of the house of origin.

ANALYSIS

Each of the provisions is discussed separately.

1. Credit For Qualified Fuel Efficient Vehicles

FEDERAL/STATE LAW

Current Federal Law

A tax credit of 10% of the cost of a qualified electric vehicle is allowed in the year that it is placed in service by the taxpayer. The vehicle must be placed in service after June 30, 1993, and before 2007. The maximum credit is \$4,000 per qualified electric vehicle; however, for vehicles placed in service in 2004 through 2006, the credit is reduced 25% each year.

A qualified electric vehicle is defined as one powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current. The credit is recaptured in the year in which the vehicle ceases to be a qualified electric vehicle.

Current State Law

California has not conformed to this federal credit.

THIS BILL

This bill would allow taxpayers that purchase new fuel efficient vehicles that have been issued a tax credit certificate a tax credit equal to \$1,000 for the purchase of that vehicle.

“Fuel efficient vehicle” would be defined as a new vehicle as described in Section 430 of the Vehicle Code that qualifies by:

- Achieving a “combined miles per gallon economy” that is at least 35% greater than the average miles per gallon fuel economy achieved by vehicles in the same California Light Duty Vehicle Conventional and Alternative Fuel Response Simulator (CALCARS) vehicle class, or
- Being a vehicle whose fuel economy is calculated in kilowatt hours per 100 miles (electric vehicles).

“Fuel efficient vehicle” does not include any vehicle with a “combined miles per gallon fuel economy” of less than 21 miles per gallon.

“Combined miles per gallon fuel economy” for a qualified vehicle would be based on the miles per gallon estimates calculated by CALCARS and would be calculated using a formula that allocates 55% as city miles per gallon and the remaining 45% as highway miles per gallon.

This bill requires the Air Resources Board (ARB) to allocate the tax credit certificates to retail dealers on a first-come, first-served basis. To receive an allocation, the retail dealer must show that the number of tax credit certificates being requested reflects the number of qualified vehicles (without certificates) held as inventory by the dealer. The retail dealer is required to list the vehicle identification number on the tax credit certificate provided to the purchaser and retain a copy in its records.

The maximum amount of credits that the ARB may allocate (in increments of \$1,000) each fiscal year is equal to the Franchise Tax Board (FTB) estimate of revenue raised in the fiscal year arising from the disallowance of deductions for large SUVs. The FTB is required to make that estimate and provide its determination to the ARB on October 1, 2004, and each October 1 thereafter. If the amount of the FTB determination is not exactly divisible by \$1,000, the number of credits would be rounded up to the next full number.

This bill requires that the taxpayer purchasing the qualified vehicle receive the tax credit certificate from the retail dealer. The taxpayer then claims the credit in the taxable year that a qualified reduced-emission vehicle that has been issued a tax credit certificate is purchased and placed in service in California. The taxpayer must retain the tax credit certificate and provide a copy upon request of the FTB.

This bill would allow any unused credit to be carried over for six years.

This bill requires that a prorated portion of the credit would be recaptured if the vehicle is sold, disposed of, or not used at least 80% in this state during the purchase year and each of the succeeding two taxable years.

This bill provides that the credit would apply to taxable years beginning on or after January 1, 2005, and before January 1, 2009, and a sunset date of January 1, 2010, is provided.

TECHNICAL CONSIDERATIONS

This bill requires that a prorated portion of the credit would be recaptured if the vehicle is sold, disposed of, or not used at least 80% in this state during the purchase year and each of the succeeding two taxable years. However, in the case where the qualified vehicle is purchased and placed in service in 2008, the sunset date for the credit of January 1, 2010, would repeal this section (including the recapture provision) before the full three taxable year recapture period. This consideration would be resolved by revising the sunset date of the credit sections to January 1, 2012.

2. Eliminate Deductions For An SUV

FEDERAL/STATE LAW

Current Federal Law

Under federal law a corporate or noncorporate taxpayer (other than estates, trusts, or certain noncorporate lessors) may elect to treat the cost of qualifying property (called Section 179 property) as a current expense rather than being required to depreciate the property over a number of years. The Jobs And Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 increased the maximum deduction for 2003, 2004, and 2005 from \$25,000 to \$100,000.

This maximum deduction is reduced, on a dollar for dollar basis, once assets costing more than \$400,000 (increased from \$200,000 by JGTRRA) have been placed in service by the taxpayer during the taxable year. This reduction is the mechanism used to target the benefit to small businesses.

Federal law also contains rules (called the luxury car limits) that limit the amount of depreciation or Section 179 expensing that can be deducted each year for certain passenger vehicles. These luxury car limits apply to leases of passenger vehicles by requiring an amount to be added to income in each year of the lease (using tables issued by the Internal Revenue Service) based on the fair market value of the vehicle for that year. For purposes of the luxury car limits, a passenger vehicle is any four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways that has an *unloaded* gross vehicle weight (i.e., curb weight fully equipped for service but without passengers or cargo) of 6,000 pounds or less. However, a passenger vehicle includes a truck or van (including a SUV or minivan) if it has a gross vehicle weight (i.e., maximum total weight of a *loaded* vehicle as specified by the manufacturer) of 6,000 pounds or less. Consequently, some large SUVs are not subject to the luxury car limits.

Current State Law

California is conformed, in general, to the federal Section 179 deduction and the luxury car limits for noncorporate taxpayers and S corporations, with the following differences:

- For non-corporate taxpayers, the maximum deduction for 2003 and later years is \$25,000.
- This maximum deduction is reduced, on a dollar for dollar basis, once assets costing more than \$200,000 have been placed in service by the taxpayer during the taxable year.

For corporations, the maximum expensing deduction is \$2,000. Also, the depreciable lives of corporate assets vary by type of asset but, in general, are longer than the depreciation period under federal law.

In addition, California allows a business operating in the following economic development areas, in lieu of the Section 179 deduction, to deduct currently as an expense (rather than depreciate) a larger portion of a depreciable asset (defined in Section 1245(a)(3) of the Internal Revenue Code):

- Enterprise Zones (EZ's),
- Local Agency Military Base Recovery Areas (LAMBRA's), and
- Targeted Tax Area (TTA).

THIS BILL

As amended April 26, 2004, with respect to large SUVs, as defined, placed in service in 2005 and before January 1, 2009, this bill would deny depreciation deductions as well as small business expense deductions (including those pertaining to enterprise zones (EZ), local area military base recovery areas (LAMBRA), and targeted tax areas (TTA)) to the owners of these vehicles.

Thus, if a taxpayer purchases a large SUV, or the taxpayer leases the large SUV under a finance lease (i.e., the taxpayer and not the leasing company is treated as the owner of the vehicle), that taxpayer would be denied depreciation deductions as well as small business expense deductions with respect to that vehicle. In addition, if the taxpayer leases a large SUV under an operating lease (i.e., the leasing company is treated as the owner of the vehicle), the leasing company would be denied depreciation deductions as well as small business expense deductions with respect to any large SUVs that are leased to others. Also, a taxpayer with an operating lease would be denied the business expense for the lease payments.

The bill exempts agricultural, timber, and construction businesses from the deduction denials.

This bill would define a large SUV as a four-wheeled vehicle manufactured primarily for use on public streets, roads, and highways if the vehicle meets all of the following requirements:

- (1) Is rated between 6,000 and 14,000 pounds gross vehicle weight,
- (2) Is designed to seat nine or fewer individuals, and
- (3) Is not equipped with an open cargo area with an interior length of 72 or more inches or does not have a covered box with an interior length of 72 or more inches that is separate from the passenger compartment.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, Oregon, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. Within the past year, *Oregon* and *New York* have considered legislation that would deny depreciation deductions and small business expense deductions with respect to large SUVs. None of the other states surveyed currently have similar laws or are proposing similar legislation.

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